

Office of Chief Counsel
Internal Revenue Service
Memorandum

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Procedure & Administration (Administrative Provisions and Judicial Practice)
CC:PA:APJP

subject: Payment of Restitution Order as Satisfaction

This memorandum responds to your request concerning a Congressional inquiry regarding a constituent's tax liability. Your office was asked for its views by

Taxpayer Advocate _____ on the tax treatment of a judgment handed down on _____, against the constituent. (the "Taxpayer" or "Defendant") Defendant was convicted of income tax evasion on _____, for filing a false income tax return for _____ under 26 U.S.C. § 7201 and ordered to pay restitution as part of his sentence.

ISSUES

1. Whether the \$ _____ that Taxpayer was ordered to pay is a payment of the tax liability only, or whether it is a separate amount that the taxpayer is ordered to pay for restitution?
2. If Counsel determines the \$ _____ is a payment of tax liability, is Taxpayer required to pay interest and penalty accruals on the unpaid balance, while making monthly payments?
3. The judgment allows for the \$ _____ to be paid in \$ _____ monthly installments. Is Taxpayer required to fill out a financial statement for IRS in order for IRS to put him on a

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\$ monthly payment agreement for the court ordered years? If so, can the IRS change the judgment amount for the monthly payment if IRS determines Taxpayer has the ability to pay more or less?

4. If the judgment is inconsistent with the plea agreement, or contains verbiage that negates the intent of the decision, what does the IRS need to do to correct this?

CONCLUSIONS

1. The \$ that Taxpayer was ordered to pay is restitution and not subject to assessment and collection under the Internal Revenue Code, even though the IRS applies the amount to reduce Taxpayer's liability.

2. Since the amount is restitution, interest would accrue under Title 18 and not Title 26 unless the IRS properly assessed the amount of the restitution.

3. Taxpayer is not required to fill out a financial statement for IRS regarding the \$ monthly payment. The restitution is being collected under the direction of the Court, and not the Internal Revenue Code, and the IRS cannot change the \$ monthly installments.

4. The question of what to do if the Judgment does not reflect the government's intentions as expressed in the plea agreement does not have to be addressed because the plea agreement is consistent with the Judgment.

FACTS

In , Taxpayer entered into a plea agreement with the United States, pursuant to which he agreed to plead guilty to tax evasion in violation of 26 U.S.C. § 7201. Subsequently, the United States District Court for the entered judgment ("Judgment"). Taxpayer was sentenced to years imprisonment and fined \$ pursuant to 18 U.S.C. § 3559 for committing a Class B felony. He was also charged a special assessment of \$.

The Judgment states what Taxpayer must do while on probation, including:

- The Defendant shall make the special assessment and restitution payments as ordered by the Court and is required to notify the Court through the Probation Officer of any material change in the Defendant's economic circumstances that might affect the Defendant's ability to meet these monetary obligations.

The Judgment also requires Taxpayer to comply with several conditions while on probation including:

- The Defendant shall pay restitution in the amount of \$ to the IRS at the rate of \$ per month.

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- The Defendant shall file truthful current and future income tax returns and cooperate with the IRS.

The Judgment directs Defendant to pay the following “Financial Penalties” (in accordance with a “Schedule of Payments set out further below):

Count	Assessment	Restitution	Fine
1	\$ \$		
Totals	\$ \$	\$	

The Judgment informs the Defendant that the “Fine And/Or Restitution” includes any cost of incarceration and/or supervision. The fine, which is due immediately, is inclusive of all penalties and interest, if applicable. The Judgment includes a provision for accruing interest on the unpaid balance (“The Defendant shall pay interest on any fine and/or restitution of more than \$2,500 . . . pursuant to 18 U.S.C. § 3612(f). All of the below payment options are subject to interest for default and delinquency pursuant to 18 U.S.C. § 3612(g).”), but, the court ultimately determined that the Defendant [does] not have the ability to pay interest and ordered that that interest requirement waived.

The Judgment directs the Defendant to make “Restitution” to the Clerk, US District Court in the amount of \$. The provision regarding “Schedule or Payments” provides that the payments shall be due in installments of \$ per month to commence 30 days after the date of the judgment.

The plea agreement provided Taxpayer with information to understand the consequences of the plea. In accepting the plea, ¶ indicates Taxpayer expected the following conditions:

The plea agreement informs Defendant as follows:

Defendant understands that the restitution to be determined during the IRS audit process may be required in this case to be determined by the presiding judge at the time of sentencing. Defendant understands that the court will take into account Defendant's financial situation and resources in determining the repayment of any restitution. Defendant agrees to truthfully complete and execute whatever documentation necessary as provided by any state or federal agency to fully determine Defendant's financial condition and status.

LAW & DISCUSSION

When a criminal investigation is underway, the IRS suspends the audit of a taxpayer that would establish a civil tax liability for income tax for a tax year. The information a criminal investigator (Special Agent) finds is generally not shared with a civil tax examiner (Revenue Agent) because information presented to a grand jury is subject to secrecy limitations under federal rules of criminal procedure. If the Department of Justice ("Justice") agrees with IRS's determination that a crime occurred, Justice will take the case. Justice's criminal prosecution focuses on proving a type of proscribed conduct (i.e., evasion) occurred, and not establishing the actual tax liability for a tax year because Justice must only establish that a substantial tax deficiency exists. See U.S. v. Kaatz, 705 F.2d 1237, 1246 (10th Cir. 1983). Typically, then Justice will focus on the larger, easily provable items of underreported income or improper deductions; other tax adjustments and any civil tax penalties are not investigated by the civil examiners until after the criminal action. See United States v. Touchet, 658 F.2d 1074, 1076 (5th Cir. 1981); United States v. Stoehr, 196 F.2d 276, 284 (3rd Cir. 1952) (The exact amount due is not normally determined in the criminal action; the determination of that amount must await the Defendant's acquiescence or a final civil judicial determination).

If a taxpayer is held criminally liable, a district court may order restitution under Title 18 of the United States Code as part of the sentencing procedures. Nevertheless, the taxpayer's liability for a year under the Internal Revenue Code is only established when IRS makes an assessment under I.R.C. § 6201. The IRS may assess any amounts shown on a tax return, but additional amounts determined by examination may be assessed only after the taxpayer has the opportunity to contest the adjustments proposed by IRS in the United States Tax Court, or the taxpayer waives the opportunity by signing a waiver and agrees to the immediate assessment by executing a Form 870. Once an amount is assessed, the Internal Revenue Code allows that liability to be collected without being reduced to a judgment using the IRS's special administrative collection authority. As to the IRS, the restitution order is, in effect, simply a direction to the taxpayer make a payment; it does not represent the defendant's correct tax liability.

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Justice's Financial Litigation Units are responsible for collecting amounts due under sentencing orders. The amount of restitution ordered by a court compensates the victim, here the government, for the unpaid tax liability of the taxpayer that is attributable to the offense for which the taxpayer is sentenced. Accordingly, the IRS applies any restitution payments against a taxpayer's unpaid liability for the tax year. See Morse, 419 F.3d at 834 n.4; see also United States v. Helmsley, 941 F.2d 71, 102 (2d Cir. 1991) ("[W]e believe it is self-evident that any amount paid as restitution for taxes owed must be deducted from any judgment entered for unpaid taxes in . . . a civil proceeding."). Note, however, that a restitution order does not provide grounds for a taxpayer to challenge any subsequent determination of civil tax liability by the IRS on the grounds of res judicata, collateral estoppel, or double jeopardy. Morse v. Commissioner of Internal Revenue Service, 419 F.3d 829, 833-35 (8th Cir. 2005).

As to Issue 1, therefore, the amount is restitution. Assessment of the amount depends on whether the taxpayer executed a Form 870 covering the restitution as part of the plea agreement or submitted a tax return (a delinquent original, or as would be relevant to the subject case, an amended return) from which the IRS made an assessment. If a Form 870 was executed or a tax return was submitted in the subject case, the \$ _____ would be subject to assessment and collection under the Internal Revenue Code.

As to Issue 2, we understand that the point of this question is whether Taxpayer's civil tax liability has been satisfied by the restitution order. We see nothing in the Judgment that indicates Taxpayer's civil tax liability has been satisfied. We would not expect the order to satisfy a civil tax liability for two reasons. First, the actual tax liability for a tax year does not have to be put before a court in a criminal proceeding as indicated by Kaatz, Touchet and Stoehr. Secondly, restitution is a Title 18 procedure; any connection to the procedures in the Internal Revenue Code in Title 26 would be made by Form 870 as indicated by Stoehr. Under the order, an amount is being collected under the direction of the Court for application to Taxpayer's account at the IRS, but the liability on that account has not been determined. The conditions of the plea agreement stated in ¶12 anticipate that the IRS may continue the audit of Taxpayer and might thereby establish the civil tax liability for income tax for the _____ tax year.

As to Issue 3, Taxpayer is not required to fill out a financial statement for IRS regarding the \$ _____ monthly payment because the IRS's procedures for installment agreements do not apply. Any changes to the terms of the payment schedule in the Judgment would be made pursuant to the direction of the Court. In this regard, the Judgment, as indicated above, provides that the Court be notified through the Probation Officer of any material change in the Defendant's economic circumstances. The condition at ¶12i of the plea agreement regarding installment agreements would come into play if the IRS continued the audit of Taxpayer and established additional liability for the _____ tax year.

As to Issue 4, we believe this question is moot because the Judgment and the plea agreement are consistent. We recognize that a question may arise regarding the

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following sentence from ¶13 of the plea agreement: “Defendant understands that the restitution to be determined during the IRS audit process may be required in this case to be determined by the presiding judge at the time of sentencing.” This language might allow for a Form 870 to be executed in time for consideration in the judgment and perhaps for Taxpayer to agree to a tax liability beyond the amount established in the criminal proceeding. In any event, the provision does not state that the Court’s Judgment will encompass the results of an audit; it indicates that it “may;” but, clearly, the Judgment does not and the provision has no effect.

A question may be raised about the terms of the Judgment in view of the recent decision in Creel v. Commissioner of Internal Revenue, 419 F.3d 1135 (11th Cir. 2005). In that case, the payment of an agreed amount in restitution was held to extinguish the Service’s ability to collect additional taxes, interest, and penalties. The facts of Creel are extremely unusual and the decision should be treated as strictly limited to its facts as indicated below.

In Creel, the taxpayer entered into a plea agreement with the United States Attorney’s Office for the Middle District of Alabama, arising out of the taxpayer’s failure to file timely federal tax returns for 1985 through 1991. As part of the plea agreement, the taxpayer agreed to file returns, and make full restitution of the loss from his failure to file returns, for 1986 through 1991. Those returns showed unpaid taxes for those years of \$83,830, and unpaid taxes of \$18,772.16 for 1985. The judgment likewise obligated the taxpayer to pay restitution; he was ordered, pursuant to 18 U.S.C. § 3663(a)(3), to “make restitution for the years 1986-1991 in the amount of ‘\$83,830 *plus any applicable penalties and interest.*’” Id. at 1138 (citation omitted from Eleventh Circuit decision). To secure the judgment, “the U.S. Attorney recorded a judgment lien against the taxpayer’s property.” Id.

The taxpayer made the required payments totaling \$83,830. After the last payment was made in June 1998, the U.S. Attorney “filed a Satisfaction of Judgment that stated: ‘The Assessment, fine, and/or restitution imposed by the Court . . . having been paid or otherwise settled, the Clerk . . . is hereby authorized and empowered to satisfy the Judgment as to the monetary imposition only.’” Id. The U.S. Attorney also recorded a Cancellation and Release stating that the judgment lien was “fully released, satisfied, discharged, and cancelled because the debt was ‘paid in full.’” Id.

In 2000, the Service sent the taxpayer a notice of intent to levy, showing additional taxes, penalties, and interest of \$284,758.28 due for the years 1985 through 1991. At the collection-due-process hearing before a Service Appeals Officer, the taxpayer asserted that his liability for those years had been satisfied, and that his payment of \$83,830 constituted accord and satisfaction. The Service disagreed, arguing that because the judgment obligated the taxpayer to pay \$83,830 *plus any applicable penalties and interest*,” id. at 1139 (emphasis in opinion), the payment did not satisfy the taxpayer’s liability. The Appeals Officer agreed with the Service.

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The taxpayer sought review from the United State Tax Court, which reversed the decision of the Appeals Officer. Relying on the taxpayer's testimony, the Tax Court "found that [the taxpayer's] payment of \$83,830 and the U.S. Attorney's issuance of a satisfaction of judgment and release of lien settled the alleged civil tax liability." Id. The Tax Court also relied on the "missing witness inference." Because the Service "did not call to the stand a representative of the U.S. Attorney's Office," the Tax Court concluded that "any relevant testimony from such a witness would have been unfavorable to the Commissioner." Id.

The Eleventh Circuit affirmed the Tax Court. Although the Court of Appeals recognized that as a general matter "the government can recover criminal penalties from an individual in a criminal prosecution and can recover additional civil penalties in a civil proceeding," id. at 1140 – indeed, the restitution statute relied on by the court "expressly contemplates that a civil claim may be brought subsequent to a criminal conviction by providing for an offset for the amount of restitution paid in the criminal case against any damages recovered in the civil proceeding," id. (citing 18 U.S.C. § 3663(e)(2) – the Court of Appeals concluded that the Service's position "fails to take into account the unique facts and the nuances of the instant case, most notably the language of the restitution judgment and the action of the U.S. Attorney." Id. (emphasis added). The plea agreement and the judgment, the Eleventh Circuit noted, both expressly required that the amount of restitution include applicable "penalties and interest." Id. (quoting Plea Agreement and Judgment (emphasis omitted).) Thus, "the restitution amount specifically included" – or more accurately, was supposed to have included – "the civil penalties that the Commissioner now seeks to recover." Id. As a result, although the civil penalties and interest were never paid, when the U.S. Attorney filed the Satisfaction of Judgment and the Cancellation and Release, he "waived" the penalties and interest. Id. (emphasis added). The Eleventh Circuit explained:

[The taxpayer] made his monthly restitution payments totaling \$83,830. As a condition of probation, [the taxpayer] still owed the "applicable penalties and interest." Rather than pursue these additional civil penalties, the U.S. Attorney undertook two key actions. First, the U.S. Attorney issued a satisfaction of judgment which stated that "[t]he assessment, fine, and/or restitution imposed by the Court in the above styled case having *been paid or otherwise settled . . .*" (emphasis added). Second, the U.S. Attorney signed a cancellation and release of lien which stated that "[t]he debt secured . . . *having been paid in full, said lien is hereby fully released, satisfied, discharged, and cancelled.*" (emphasis added). [The taxpayer] argues that because the government elected to include his civil tax liabilities as part of the restitution order, when the U.S. Attorney discharged the restitution obligation, Creel's civil tax liabilities were also extinguished. We agree.

Id. (emphasis in bold added) (paragraph break omitted).

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The situation presented in Creel is different from the one presented here in two very important respects. First, in this case, the judgment does not include the payment of penalties and interest. Therefore, a Satisfaction of Judgment would not necessarily be a satisfaction of unpaid tax liabilities, including interest and penalties. The Judgment does not address interest and penalties under the Internal Revenue Code. The Plea Agreement contains the taxpayer's express agreement that "he shall pay in full all outstanding tax liabilities once assessed, including penalties and interest, or enter into an installment plan with the Collection Division of the Internal Revenue Service," (Plea Agreement § 12(g) (emphasis added)). This agreement does not relate to the restitution ordered by the Court but, rather, to any liability under the Internal Revenue Code that might arise if the IRS continued the audit of Taxpayer and established additional liability for the _____ tax year. Thus, even a very broad Satisfaction of Judgment should not be read as saying that interest and penalties under the Internal Revenue Code have been satisfied.

Second, even if the Plea Agreement and Judgment were read as requiring Taxpayer to pay all taxes, penalties, and interest owed, Creel does not stand for the proposition that a court-ordered amount to be paid in restitution is, or somehow must be, equal to the amount of the taxes, penalties, and interest owed by a taxpayer. To the contrary, Creel stands for the exact opposite. In Creel, the Eleventh Circuit recognized that the taxpayer's restitution payments did not include the full amount owed to the Service, but it found that the U.S. Attorney had compromised the full amount owed by filing the Satisfaction of Judgment and Cancellation and Release. Here, because there has been no waiver or compromise of the full amount owed – by filing a Satisfaction of Judgment, or a Cancellation and Release, or by any other conduct by the Service or one of its agents – the Service retains the right to collect the full amount owed to it.

Please call John Moran of CC:PA:APJP:B02 at
regarding this memorandum.

if you have questions